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Draft Model Law on Secured Transactions

Note by the Secretariat

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Chapter I. Scope of application and general provisions

Article 1. Scope of application

1. This Law applies to all rights in movable assets created by agreement that secure the payment or other performance of an obligation, regardless of the form of the transaction or the terminology used by the parties, the type of asset, the status of the grantor or secured creditor, or the nature of the secured obligation.

2. Subject to article 87, the Law applies to outright transfers of receivables.

[3. Notwithstanding paragraphs 1 and 2 of this article, this Law does not apply to:

(a) Rights to draw under an independent undertaking;

(b) Aircraft, railway rolling stock, space objects, ships as well as other categories of mobile equipment in so far as such asset is covered by other law and the matters covered by this Law are addressed in that other law;

[(c) Intellectual property in so far as this Law is inconsistent with law relating to intellectual property;][1]

(d) [Intermediated] securities;

(e) Payment rights arising under or from financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions;

(f) Payment rights arising under or from foreign exchange transactions;

(g) Proceeds of an excluded type of asset even if the proceeds are of a type of asset to which this Law applies, but only to the extent that other law applies; and

(h) [...].][2]

4. This Law does not apply to a security right created in favour of an individual for his or her personal, family or household purposes.

5. Nothing in this Law affects the rights and obligations of a grantor or a debtor of an encumbered receivable under special laws relating to the protection of parties to transactions made for personal family or household purposes.

[6. Paragraphs 4 and 5 of this Law apply to [small enterprises] [micro-businesses].]

7. Except as provided in articles 74 and 75, nothing in this Law overrides contractual or legal limitations on the creation or enforcement of a security right in, or the transferability of, specific types of asset.

[*Note to the Working Group: The Working Group may wish to consider paragraph 3 of this article once it has completed the first reading of the draft Model Law. With respect to consumer transactions, the Working Group may wish to note that: (a) paragraph 4, which is based on article 4, subparagraph 1 (a) of the* United Nations Convention on the Assignment of Receivables in International Trade

[1] The enacting State will have to adjust this provision to fit its intellectual property law.

[2] If the enacting State decides to introduce any other exception(s), they should be limited and set out in a clear and specific way.

*(the "*Assignment Convention*"), is intended to exclude secured transactions in which the secured creditor is a consumer; (b) paragraph 5, which is based on article 4, paragraph 4 of the* Assignment Convention*, is intended to implement the policy of recommendation 2, subparagraph (b) of the* UNCITRAL Legislative Guide on Secured Transactions *(the "*Secured Transactions Guide*"), resulting in the application of the draft Model Law to secured transactions in which the grantor or the debtor of an encumbered receivable is a consumer, subject to consumer protection legislation; and (c) both paragraphs 4 and 5 follow the formulation of the* Assignment Convention *(which followed the formulation of the* United Nations Convention on Contracts for the International Sale of Goods *(the "*CISG*"), article 2, subpara. (a)) and refer to the purpose of a transaction rather than to the term "consumer", as the exact meaning of that term would vary from State to State. The Working Group may also wish to note that paragraph 6 is intended to implement a suggestion made at the 24th session of the Working Group that the protection afforded by the draft Model Law to consumers might be extended to micro-businesses (A/CN.9/796, para. 47). If the Working Group decides to retain paragraph 6, it may wish to consider whether a more neutral term could be used that would fit all States. Alternatively, the Working Group may wish to consider whether the guide to enactment of the draft Model Law (the "Guide to Enactment") should explain that the exact meaning of the term "small enterprise", "micro-business" or any other similar term that might be used should be left to each enacting State as what is a small or micro-business would vary from State to State.*]

[Article 2. Definitions

For the purposes of this Law:

[*Note to the Working Group: The Working Group may wish to note that the definitions of the terms "acquisition secured creditor" and "acquisition security right", "financial lease right" and "retention-of-title right" that were included in the terminology of the* UNCITRAL Legislative Guide on Secured Transactions *(the "*Secured Transactions Guide*") have been moved to Annex I on acquisition financing. The Working Group may also wish to note that the references to the unitary and non-unitary approach to secured transactions in the relevant definitions have been deleted as they do not fit in a model law and have been included in Annex I on acquisition financing. The Working Group may also wish to note that, if the Working Group decides that security rights in intellectual property should be covered in the draft Model Law, it may wish to consider whether the definitions included in the* Supplement on Security Rights in Intellectual Property *(the "*Intellectual Property Supplement*") should be added to article 2.*]

(a) "Assignee" means a person to which an assignment of a receivable is made;

(b) "Assignment" means the creation of a security right in a receivable that secures the payment or other performance of an obligation. For convenience of reference, the term also includes an outright transfer of a receivable;

(c) "Assignor" means a person that makes an assignment of a receivable;

(d) "Bank account" means an account maintained by a bank, to which funds may be credited. The term includes a checking or other current account, as well as a

savings or time deposit account. The term does not include a right against the bank to payment evidenced by a negotiable instrument;

[*Note to the Working Group: The Working Group may wish to note that the definitions of the terms "attachment to a movable asset" and "attachment to immovable property", as well as the relevant recommendations have been deleted in the interest of addressing in the draft Model Law key issues and referring for the rest to the recommendations of the* Secured Transactions Guide. *The Working Group may also wish to note that the definitions of terms such as "insolvency court", "insolvency estate" and "insolvency proceedings", and the insolvency chapter of the* Secured Transactions Guide, *have been deleted, as insolvency matters, including definitions, would normally be addressed in insolvency law.*]

(e) "Competing claimant" means a creditor of a grantor that is competing with respect to an encumbered asset with another creditor of the grantor having a security right in the encumbered asset of the grantor and includes:

(i) Another creditor with a security right in the same encumbered asset (whether as an original encumbered asset or proceeds);

(ii) The [enacting State to determine whether reference should be made to an acquisition secured creditor only or also to a seller or financial lessor] of the same encumbered asset that has retained title to it;

(iii) Another creditor of the grantor that has a right in the same encumbered asset;

(iv) The insolvency representative [and creditors] in the insolvency proceedings in respect of the grantor; or

(v) Any buyer or other transferee (including a lessee or licensee) of the encumbered asset;

[*Note to the Working Group: The Working Group may wish to consider whether the bracketed text in subparagraph (iv) should be retained, as in some jurisdictions the estate is represented by the insolvency representative, while in other jurisdictions the estate is represented by the mass of creditors.*]

(f) "Consumer goods" means tangible assets that a person uses or intends to use for personal, family or household purposes;

(g) "Debtor" means a person that owes payment or other performance of a secured obligation and includes a secondary obligor such as a guarantor of a secured obligation. The term includes for convenience of reference an assignor in an outright transfer of a receivable. The debtor may or may not necessarily be the grantor;

(h) "Debtor of the receivable" means a person liable for payment of a receivable and includes a guarantor or other person secondarily liable for payment of the receivable;

(i) "Encumbered asset" means a movable, tangible or intangible, asset that is subject to a security right. The term also includes for convenience of reference a receivable that has been the subject of an outright transfer;

(j) "Equipment" means a tangible asset used by a person in the operation of its business;

(k) "Future asset" means a movable asset, which does not exist or which the grantor does not own or have the power to encumber, at the time the security agreement is concluded;

(l) "Grantor" means a person that creates a security right to secure either its own obligation or that of another person, including [the enacting State to determine whether reference should be made also to a retention-of-title buyer and financial lessee]. The term also includes an assignor in an outright transfer of a receivable;

(m) "Insolvency representative" means a person or body, including one appointed on an interim basis, authorized in insolvency proceedings to administer the reorganization or the liquidation of the insolvency estate;

(n) "Intangible asset" means all forms of movable assets other than tangible assets and includes incorporeal rights, receivables and rights to the performance of obligations other than receivables;

(o) "Inventory" means tangible assets held for sale or lease in the ordinary course of a grantor's business, as well as raw and semi-processed materials (work-in-process);

(p) "Knowledge" means actual rather than constructive knowledge;

(q) "Mass or product" means tangible assets other than money that are so physically associated or united with other tangible assets that they have lost their separate identity;

(r) "Notice" means a communication in writing;

[*Note to the Working Group: In view of the definitions of the term "notice" in the* Secured Transactions Guide *and in the* UNCITRAL Guide on the Implementation of a Security Rights Registry *(the "*Registry Guide*"), the Working Group may wish to consider whether a new term should be introduced and defined in this article to reflect a notice to be registered in the general security rights registry (e.g. "registration notice" or "security right notice"), while the current definition of the term "notice" could be retained to refer to other types of notice (e.g., given in the context of enforcement).*]

(s) "Notification of the assignment" means a notice that reasonably identifies the assigned receivable and the assignee;

[*Note to the Working Group: The Working Group may wish to consider this definition states a substantive rule on the effectiveness of a notification of the assignment that is already addressed in article 82, paragraph 1.*]

(t) "Original contract" means, in the context of a receivable created by contract, the contract between the creditor and the debtor of the receivable from which the receivable arises;

(u) "Possession" means the actual possession only of a tangible asset by a person or an agent or employee of that person, or by an independent person that acknowledges holding it for that person. It does not include non-actual possession described by terms such as constructive, fictive, deemed or symbolic possession;

(v) "Priority" means the right of a person to derive the economic benefit of its security right in preference to a competing claimant;

(w) "Proceeds" means whatever is received in respect of encumbered assets, including what is received as a result of sale or other disposition or collection, lease or licence of an encumbered asset, proceeds of proceeds, civil and natural fruits, dividends, distributions, insurance proceeds and claims arising from defects in, damage to or loss of an encumbered asset;

(x) "Receivable" means a right to payment of a monetary obligation, excluding a right to payment evidenced by a negotiable instrument, a right to receive the proceeds under an independent undertaking and a right to payment of funds credited to a bank account;

(y) "Regulation" means the body of rules adopted by the enacting State with respect to a registry for the purposes of receiving, storing and making accessible to the public information in registered notices with respect to security rights in movable assets[, whether these rules are found in administrative guidelines or the Law];

(z) "Right to receive the proceeds under an independent undertaking" means the right to receive a payment due, a draft accepted or deferred payment incurred or another item of value, in each case to be paid or delivered by the guarantor/issuer, confirmer or nominated person giving value for a draw under an independent undertaking. The term also includes the right to receive payment in connection with the purchase by a negotiating bank of a negotiable instrument or a document under a complying presentation. The term does not include:

(i) The right to draw under an independent undertaking; or

(ii) What is received upon honour of an independent undertaking;

(aa) "Secured creditor" means a creditor that has a security right. For convenience of reference, the term also includes an assignee in an outright transfer of a receivable;

(bb) "Secured obligation" means an obligation secured by a security right. [For convenience of reference, the term also includes the amount owing by the transferor in the case of an outright transfer of a receivable;]

[*Note to the Working Group: The Working Group may wish to note that the bracketed text is intended to facilitate the application of the articles of the draft Model Law that include a reference to the term "secured obligation" to an outright transfer of receivables. Alternatively, text should be included in all relevant articles to address their proper application to outright transfers of receivables (see, for example, article 5, subpara. 2 (c) below).*]

(cc) "Secured transaction" means a transaction that creates a security right. For convenience of reference, the term also includes an outright transfer of a receivable, without re-characterizing it as a secured transaction;

(dd) "Security agreement" means an agreement, in whatever form or terminology, between a grantor and a secured creditor that creates a security right. For convenience of reference, the term also includes an agreement for the outright transfer of a receivable;

(ee) "Security right" means a property right in a movable asset that is created by agreement and secures payment or other performance of an obligation, regardless of whether the parties have denominated it as a security right. For convenience of reference, the term also includes the right of the assignee in an outright transfer of a receivable; and

(ff) "Tangible asset" means every form of corporeal movable asset, such as consumer goods, inventory and equipment.]

[Article 3. Party autonomy

1. Except as otherwise provided in articles [...], the parties may derogate from or vary by agreement the provisions of this Law relating to their respective rights and obligations. Such an agreement does not affect the rights of any person that is not a party to the agreement.

2. The mutual rights and obligations of the parties to a security agreement are determined by:

(a) The terms and conditions set forth in the security agreement, including any rules or general conditions referred to therein; and

(b) Any usage to which the parties to the security agreement have agreed and any practices they have established between themselves.]

[*Note to the Working Group: The Working Group may wish to note that paragraph 1 of this article: (a) is based on article 6 of the* Assignment Convention *(the first part of which is based on article 6 of the* CISG*) and recommendation 10 of the* Secured Transactions Guide *(which refers to specific mandatory law recommendations); and (b) is intended to refer not only to the secured creditor and the grantor but also to other parties whose rights may be affected by the draft Model Law, such as the debtor of an encumbered receivable and a competing claimant, while ensuring that any person not party to such an agreement will not be affected. The Working Group may also wish to note that paragraph 2 of this article: (a) is based on article 11 of the* Assignment Convention *(which in turn is based on article 9 of the* CISG*) and recommendation 110 of the* Secured Transactions Guide *and (b) is intended to reiterate the principle that the parties to the security agreement may structure their agreement in any way they wish to meet their particular needs (as is done in articles 6 and 11 of the* Assignment Convention*, but not in articles 6 and 9 of the* CISG*); and (b) give legislative strength to trade usages agreed upon by the parties and trade practices established between them.*]

Article 4. General standard of conduct

1. A person must exercise its rights and perform its obligations under this Law in good faith and in a commercially reasonable manner.

2. The general standard of conduct set forth in paragraph 1 of this article cannot be waived unilaterally or varied by agreement at any time.

Chapter II. Creation of a security right and rights and obligations of the parties

Section I. Creation of a security right

Article 5. Security agreement

1. A security right is created by a security agreement in accordance with paragraphs 2 to 5 of this article.

2. A security agreement must:

(a) Provide for the creation of a security right;

(b) Identify the secured creditor and the grantor;

(c) Describe the secured obligation [except in the case of an outright transfer of receivables];

(d) Describe the encumbered assets in a manner that reasonably allows their identification[; and

(e) Indicate the maximum monetary amount for which the security right may be enforced].[3]

3. Subject to paragraph 4 of this article, the security agreement must be [contained in] [concluded in] [evidenced by] [contained or concluded in, or evidenced by] a writing that satisfies the minimum content requirements of paragraph 2 of this article and is signed by the grantor.

4. A security agreement may be oral if accompanied by a transfer of the possession of the encumbered asset to the secured creditor.

[*Note to the Working Group: The Working Group may wish to consider: (a) whether the bracketed text in subparagraph 2 (c) should be retained or the matter addressed in the definition of the term "secured obligation" (see article 2, subpara. (bb) above) and in the Guide to Enactment; and (b) whether the meaning of the terms "writing" and "signature" in an electronic context should be addressed in the Guide to Enactment by reference to recommendations 11 and 12 of the* Secured Transactions Guide *and/or in the definitions. The Working Group may wish to note that paragraph 1 is based on recommendation 13 of the* Secured Transactions Guide, *paragraph 2 on recommendation 14, and paragraphs 3 and 4 on recommendation 15.*]

Article 6. Obligations that may be secured

A security agreement may provide for a security right that may secure any type of obligation, whether present or future, determined or determinable, conditional or unconditional, or fixed or fluctuating.

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[3] This subparagraph should be included in the draft Model Law if the enacting State determines that an indication of the maximum monetary amount for which the security right may be enforced would be helpful to facilitate lending from another creditor.

Article 7. Assets that may be encumbered

1. A security agreement may provide for a security right in any type of asset, parts of assets and undivided rights in assets.

2. A security agreement may provide for a security right in future assets but the security right is not created until the grantor acquires rights in the assets or the power to encumber them.

3. A security agreement may provide for a security right in all assets or categories of assets of a grantor, without identifying them individually.

Article 8. Proceeds

1. A security right in an encumbered asset extends to its identifiable proceeds.

2. Where proceeds in the form of money or funds credited to a bank account have been commingled with other assets of the same kind so that the proceeds are no longer identifiable:

(a) The amount of the proceeds immediately before they were commingled is nevertheless to be treated as identifiable proceeds after commingling; and

(b) If, at any time after commingling, the total amount of the asset is less than the amount of the proceeds, the total amount of the asset at the time that its amount is lowest plus the amount of any proceeds later commingled with the asset is to be treated as identifiable proceeds.

Article 9. Assets commingled in a mass or product

1. A security right created in tangible assets before they were commingled in a mass or product continues in the mass or product.

2. A security right in tangible assets that continues in a mass or product pursuant to paragraph 1 of this article is limited in value to the value of the encumbered assets immediately before they became part of the mass or product.

Section II. Rights and obligations of the parties to a security agreement

Article 10. Obligation to preserve an encumbered asset

A [party to a security agreement] [secured creditor] that is in possession of an encumbered asset must take reasonable steps to preserve the asset and its value.

[*Note to the Working Group: The Working Group may wish to consider whether, to ensure that this article would not result in preventing the grantor from selling the asset or in making it possible for the grantor to avoid this duty by relinquishing possession, the obligation to preserve the encumbered asset should be limited to the secured creditor (if the cost of preserving the encumbered asset exceeds its value, the secured creditor would normally not only relinquish possession but take other steps to address the lack of security). Alternatively, the matter could be addressed in the Guide to Enactment.*]

Article 11. Obligation of secured creditor to return an encumbered asset or register a cancellation notice

If the secured obligation has been fully satisfied and all commitments to extend credit have been terminated, the secured creditor must return an encumbered asset in its possession to the grantor, or register a cancellation notice as provided in article 50.

[*Note to the Working Group: The Working Group may wish to consider whether this article or the Guide to Enactment should address the obligation of an assignee to withdraw the notification to the debtor of the receivable.*]

Article 12. Rights of a secured creditor with respect to an encumbered asset

1. A secured creditor in possession of an encumbered asset is entitled:

(a) To be reimbursed for reasonable expenses incurred for the preservation of the asset;

(b) To make reasonable use of the asset; and

(c) To apply the monetary proceeds of the asset to the payment of the secured obligation.

2. A secured creditor is entitled to inspect an encumbered asset in the possession of the grantor [at all reasonable times] [in a reasonable manner].

[*Note to the Working Group: The Working Group may wish to consider whether the bracketed text in paragraph 2 of this article should be deleted as the obligation of the parties exercise their rights and perform their obligations in good faith and in a commercially reasonable manner is already addressed in article 4 (general standard of conduct).*]

Chapter III. Effectiveness of a security right against third parties

Article 13. Methods of third-party effectiveness

A security right is effective against third parties, if it has been created in accordance with article 5, paragraph 1, and:

(a) A notice with respect to the security right that meets the requirements of articles 25, 39, 46, 47 and [...] is registered in the general security rights registry [or in a specialized registry or title certificate, if any]; or

(b) The possession of the asset encumbered by the security right is transferred to the secured creditor.

[*Note to the Working Group: The Working Group may wish to consider whether subparagraph (a) of this article should refer to other articles setting forth requirements for a notice to achieve the third-party effectiveness of a security right.*]

Article 14. Automati third-party effectiveness of a security right in proceeds

1. If a security right in an encumbered asset is effective against third parties, a security right in any proceeds of the encumbered asset is effective against third parties without any new act when the proceeds arise or are acquired if:

(a) The proceeds are sufficiently described in the notice registered; or

(b) Consist of money, receivables, negotiable instruments or rights to payment of funds credited to a bank account.

2. If a security right in an encumbered asset is effective against third parties, a security right in any proceeds other than those referred to in paragraph 1 of this article is effective against third parties:

(a) For [a short period of time to be specified by the enacting State] days after the proceeds arise; and

(c) Thereafter, if it is made effective against third parties by one of the methods referred to in article 13 before the expiry of the time period provided in subparagraph (a).

[Article 15. Continuity in third-party effectiveness of a security right upon a change in the method of third-party effectiveness

1. A security right made effective against third parties by one of the methods referred to in article 13 may [subsequently] be made effective against third parties by another of those methods.

2. Even if there is a change in the method of third-party effectiveness, third-party effectiveness continues, provided that there is no time when the security right is not effective against third parties.]

[Article 16. Lapse in third-party effectiveness

If third-party effectiveness of a security right lapses, it may be re-established by any of the methods referred to in article 13. In such a case, the security right is effective against third parties only as of the time of re-establishment.]

[*Note to the Working Group: The Working Group may wish to consider that articles 15 and 16 appear within square brackets for further consideration in view of the doubts expressed with respect to those articles at the 24th session of the Working Group (see A/CN.9/796, paras. 58-61). The Working Group may wish to consider whether articles 15 and 16 could be merged in one article.*]

Article 17. Effect of a transfer of an encumbered asset

Except as otherwise provided in this Law, a security right does not become ineffective as against third parties solely because the encumbered asset is transferred.

[*Note to the Working Group: The Working Group may wish to consider whether the rule that a security right follows an encumbered asset in the hands of a transferee fits more in the chapter on creation and the exceptions to this rule (authorization of the transfer by the secured creditor or transfer in the ordinary*

course of business of the transferor) in the chapter on priority, or whether both the rule and its exceptions should be included in the chapter on priority.]

Article 18. Continuity in third-party effectiveness upon change of the applicable law to this Law

If a security right is effective against third parties under the law of another State whose law was applicable, and this Law becomes applicable, the following rules apply:

(a) The security right continues to be effective against third parties under this Law for [a short period of time to be specified by the enacting State] days after the change;

(b) The security right continues to be effective against third parties after the end of the time period referred to in subparagraph (a) if the third-party effectiveness requirements of this Law are satisfied prior to the end of that time period; and

(c) If the security right continues to be effective against third parties under subparagraph (a) and (b), the time when registration or third-party effectiveness was achieved for the purposes of the articles on priority is the time when it was achieved under the law of the other State.

[*Note to the Working Group: The Working Group may wish to note that the Guide to Enactment will explain that this article, which is based on recommendation 45 of the* Secured Transactions Guide, *is intended to apply to cases in which the draft Model Law becomes the applicable law by virtue of the conflict-of-laws rules of the forum (e.g., through a move of the location of the asset or the grantor to the enacting State) and is intended to give a secured creditor a grace period to ensure that the third-party effectiveness of its security right achieved under the previously applicable law continues under the draft Model Law (for a similar "transition" rule in the case of a change of the law of one and the same State, see rec. 231 of the* Secured Transactions Guide*).*]